Statement of Dale Leighty - ICBA
House Agriculture Committee
June 20, 2001

Review of Agricultural Credit Issues

Thank you Chairman Lucas and other members of this subcommittee for holding these important hearings on ag credit issues today. Mr. Chairman, we appreciate the House Agriculture Committee's efforts in pursuing a fourth consecutive farm aid package. ICBA has lobbied for and supported each farm aid package over the last several years, so we want to express our sincere appreciation to you and other members of Congress. We believe the economic assistance was necessary to help stabilize the financial viability of many farmers and ranchers.

My name is Dale Leighty, and I serve as the Chairman of ICBA's Agriculture-Rural America Committee and I am also the President of the First National Bank of Las Animas in Las Animas, Colorado. Ours is an $100 million asset bank and with approximately $75 million in loans, most of which are agricultural credits. Our town has 2,500 people and our county has 5,500 residents.

Mr. Chairman, the ICBA, with two-thirds of our member banks located in small communities of under 10,000 population, has a long standing interest in ensuring credit availability to our nation's farmers, small businessmen and women and other consumers in our nation's rural communities. ICBA is the only national trade organization that exclusively represents the interests of our nation's community banks

This hearing is very timely for a couple of reasons. First, obviously, is the need to rewrite the Farm Bill during the 107th Congress since the current bill expires in 2002 and there is great uncertainty about the future for many farm families. Unfortunately, farmers today face the 'triple whammy' of despairingly low prices, sharply rising energy and input costs and an unlevel playing field in the international trade arena. Therefore, we urge Congress to develop farm bill legislation that will work hand in hand with an aggressive U.S. trade policy initiative because what we do in our domestic farm policy must be interwoven with our broader national trade goals for American agriculture.

This agenda must entail as broad access as possible for our farmers to the markets of other nations and it must lead to the dismantling of trade barriers, export subsidies and other trade distorting practices engaged in by Europe, Japan and other countries. In fact, the committee may find it appropriate to revisit farm policy after completion of important trade initiatives over the next few years to ensure our farmers have all necessary tools to compete on a level playing field.

Strengthening the Farm Safety Net

From our perspective, what you do as a committee on a farm aid package for this year and then in subsequent long-term farm policy will impact the agricultural credit situation of our nation's farmers and ranchers as much as other elements of a farm bill credit title.

The policies you set forth in the new farm bill will affect not only family farmers and ranchers but also thousands of community banks across the nation and the communities that depend on them. Therefore, we look forward to working with you on the important challenges that impact our farm customers and our industry.

In order to rejuvenate American agriculture we believe several policies should be pursued including some which lie outside the bounds of a new farm bill. We believe the short term actions Congress should pursue include: 1) quickly adopting a new farm aid package; 2) passage of a farm bill with counter-cyclical income mechanisms; 3) providing full funding and new program authorities for USDA guaranteed loan programs; 4) complimenting domestic farm programs with an aggressive U.S. trade policy; and 5) adopting new policies that attract capital and business opportunities to rural America. This latter recommendation has a number of specific aspects which my testimony will address.

Quickly Adopting A New Farm Aid Package

We believe it would be appropriate for Congress to quickly adopt a farm aid package that provides similar levels of assistance for those crops and commodities needing assistance as Congress adopted last year. Another round of economic assistance before Congresses passes the new farm bill will help producers offset the impact of extremely low farm prices and keep their cash flows acceptable to lenders. ICBA has supported these farm aid packages because we believe they are necessary to prevent an agricultural credit crisis that could have developed in the absence of such assistance.

We recognize that ultimately farmers need to earn their income from the market to be viable, but a number of factors outside the control of farmers, including events in the broader economy and on the world stage, coalesced to drive down farm prices and dramatically reduce our farm exports. We have also recognized that many of the farm trade issues, so important to agriculture's health, will take considerable time to work out as part of the world trade negotiations. USDA's recent supply and demand figures indicate it will be another tough year for many farmers. Farm prices for many commodities will remain low due to continued large carryover levels for most major commodities.

A Farm Bill with Counter-Cyclical Income Mechanisms

For the past couple of years ICBA has urged Congress to adopt a counter cyclical farm income mechanism to allow payments to fluctuate inversely with commodity prices. This approach would automatically provide farmers with payments in years of extremely low prices and thus avoid the need of future ad hoc farm aid packages.

We recognize the difficulty the committees will have in working out the specific details of a new counter cyclical farm program but we believe a move in this direction, perhaps coupled with some form of AMTA payments, would be appropriate and help sustain farm incomes until market prices recover and we work our way through the persistently thorny trade briar patch.

The new budget baseline provides roughly $80 billion to agriculture's baseline over the next decade and a minimum of $12.5 billion for the 2001 and 2002 crop years. Last year ICBA suggested a special fund be set up as part of a multi-year budget that would provide increased money to agriculture in low-price years. We believe the new "reserve fund" mentioned in the budget is consistent with a counter-cyclical approach and can provide funding flexibility in the next farm bill to boost farm income in low-price years.

Predictability is Key: I believe what everyone, including both farmers and their lenders, are trying to achieve is a greater degree of predictability so that farmers and their lenders don't have to rely on annual, ad-hoc disaster packages. That wasn't a good recipe for crop insurance and it isn't a good recipe for farm financing either. More predictability will allow lenders and their farm customers to make timely business and financing decisions and to have a better grasp – earlier – of cash flow statements. Producers and their lenders need to have the ability to make three to five year crop projections based on the known amount of income available and this level of income needs to be sufficient to allow farmers to meet their debt obligations and family living needs.

We note Congress has considered adopting Farm, Fish and Ranch Risk Management (FFARRM) accounts that would allow producers to defer taxes on up to 20 percent of their net income for up to five years. Congress could remove the five-year limitation so all farmers could place a portion of this money into a longer term retirement account rather than mandating a forced withdrawal. We believe these accounts should be limited to federally insured depository institutions to protect farmers and their finances.

Increase Risk Management Tools: We recommend Congress adopt of goal of eventually making crop insurance mandatory for producers who receive government payments, just as conservation compliance is today. A short timeline could be established in law for when this mandatory compliance would kick in, contingent upon Congress being satisfied with the performance of the newly enhanced program.

We are pleased that the new crop insurance program has been substantially enhanced. Crop insurance is an important cornerstone to a strong farm safety net. From a lender's standpoint, crop insurance is especially important because it better enables producers to repay their loans and withstand economic adversity when major weather disasters strike.
The program needs to be attractive enough to sustain high levels of farmer participation so Congress does not feel inclined to pass annual ad hoc disaster programs, which only further detracts from participation and raises budget costs. So we should evaluate how crop insurance functions over the next couple of years and if it is performing satisfactorily, then we should then mandate its compliance within certain guidelines.

USDA Guaranteed Loan Programs

ICBA recommends the next farm bill provide sufficient funding and flexibility for USDA guaranteed loans programs. One recommendation for the next farm bill's credit title is to include language that provides a "cushion" against running out of appropriated funding. An option would be to provide for a back-up line of credit to the Treasury for $10-$20 million that could be tapped by the Secretary if the Chairman and Ranking Members of the House and Senate Agriculture and Appropriations committees agree that allocation of the funds are necessary. This would be to protect against these funds running out due to unusually high demand. This small amount would leverage well over $1 billion in additional guaranteed loans.

In recent years Congress had to pass supplemental appropriations bills to provide additional funding for guaranteed loans while farmers were trying to get financing to get their crops planted. Farmers were complaining to bankers because they couldn't get their production loans and bankers were being told that there was no more funding available until Congress and the President agreed to supplemental appropriations legislation, which at times becomes embroiled in non-related issues.

Let's keep in mind as Congress considers ways to strengthen the farm safety net that guaranteed loan programs offer the most "bang for the buck" because private sector lenders are providing the loan funds, not the government. However, when these programs run out of money it severely undermines their credibility and increases frustration in the countryside. The FSA loan portfolio has witnessed improved performance with direct loan delinquency down to its lowest level in more than two decades. And, importantly from the standpoint of lenders, is the loan delinquency for guaranteed loans is at an all-time low of 1.83 percent.

We offer the following recommendations for FSA loan programs:

- Provide a permanent back-up or contingency funding mechanism to provide uninterrupted program operation when congressionally appropriated funds become exhausted;
- Provide the Secretary greater flexibility in transferring funds between programs especially in times of greater funding needs;
- Permanently eliminate the 15-year limit on eligibility by allowing lenders and farmers to determine when they need guaranteed loans since private sector lenders provide the loan funds under the guaranteed programs;
- Increase the loan limit, at least on a case-by-case basis, on FSA loans to better reflect the needs of modern-day agriculture. The loan limit was recently increased slightly and indexed to influation, but many lenders complain it is still not adequate;
- Consideration of providing a greater interest rate subsidy when national interest rates increase; and
- Continue streamlining USDA's direct and guaranteed loan paperwork and enhance computer/online access to all necessary USDA documents.

Mr. Chairman, I would also like to go into more depth on a few additional suggestions. These would be as follows:

Aggie Bonds: ***Allow FSA guarantees to be used with Aggie Bonds*** which will lower the effective interest rates and allow better cash flows for young, beginning and marginal farmers. The farm population is aging. Limits on farm ownership funds has limited the ability of the next generation to get started in farming. FSA procedure prohibits the use of guaranteed loans in conjunction with many Beginning Farmer programs conducted in various states because the funds are generated by tax free bonds. The use of tax free funds by guaranteed lenders would be a valuable tool to help these producers obtain rates and terms that they can meet. This prohibition from financing in conjunction with tax free funds obstructs FSA's ability to work with participation and other types of joint financing which involve these Aggie bones and other tax free bonds. Therefore, we urge you to revise statutes to allow the use of guaranteed loans with tax free bonds.

For Aggie Bonds to become widely available to more farm states and farmers there is another fix is also necessary before the above change can be fully effective: ***exempt Aggie Bonds from the Congressionally set state volume cap formulas on industrial revenue bonds***. Several states often cannot meet the demand for Aggie Bonds because they do not have sufficient volume cap to meet overall demand for tax exempt bonds. Other states would like to start offering Aggie Bonds but are effectively prevented from doing so because they already have more demand for other bond uses than their state volume cap can accommodate. Most of the private-activity, tax – exempt bond volume is used by corporations for manufacturing or for multi-family housing projects. These bonds are typically issued for millions of dollars, underwritten and sold to investors. In contrast, Aggie Bonds are used by young farm and ranch families and cannot exceed $250,000 per bond. These bonds are typically held by the local lender such as a local bank. The Aggie Bond programs could be much more effective and useable to a new generation of farmers if they did not have to compete with large industrial manufacturing and housing projects under the current federal guidelines. We encourage the House and Senate agriculture committees to work with the other appropriate committees in Congress to ensure that these promising changes quickly become a reality.

Interest Assist Program: The Interest Assist (IA) program expires in September 2002. The program can be a valuable tool in helping farmers by buying down their interest rate. However, some lenders have complained that it is being abused by some lenders who use it as a marketing tool to attract loans away from other lenders. Therefore, the program may need to have some additional conditions placed upon its use.

Guaranteed Farm Storage Loans: We recommend Congress adopt a guaranteed lending program for on-farm storage in addition to the existing direct loan program as part of the new farm bill. Guaranteed loans are a more effective use of the government funds than are direct funds and currently there is only a direct program being offered. This arrangement competes against loans the private sector could be making and we believe there are more cost-effective ways to accomplish the goals of this program.

Blanket Assignment Form: ICBA recommends Congress allow borrowers to execute a single blanket assignment form to assign all present and future payments to their lenders. This would reduce paperwork burdens by both borrowers and lenders and speed up decision making. In recent years a large number of new programs, including varius "ad hoc" programs, have been implemented to distribute agency funds to farmers. For each new program, FSA and other lenders must process a new assignment form. Generating a new form for each program creates an unnecessary burden for farmers, lenders and FSA staff. A blanket or single assignment form assigning all present and future FSA program payments, including payments derived from "ad hoc" programs that are not in existence on the date the assignment is executed would address this problem. The assignment could assigned annually.

Other Farm Policy Issues

Enhance Conservation Initiatives & the CRP: ICBA believes that conservation should continue to be an important cornerstone of new farm policy. In this regard we believe that more producer choice should be provided to farmers in terms of choosing the length of their Conservation Reserve Program (CRP) contracts. Producers should be allowed to choose between three-year, five-year, and seven-year contracts so that land does not have to be idled for 10-year periods, which may cause too much economic disruption.

Addressing Food Aid & World Hunger Needs: It is also important that we continue our focus on efforts to aid hungry and malnourished people in other countries in a constructive and positive way. Food aid commitments to needy foreign nations should be increased, and the functionality of these programs should be reviewed to assess ways to improve cost efficiencies.

We believe the private sector, including the World Bank and regional development banks such as the Inter-American and Asian Development Banks can help assist in developing the infrastructure necessary to allow efficient food transportation to hungry people in poor countries. Proper monitoring and oversight mechanisms also should be established to help ensure that food shipments get to the people in needy countries and are not diverted.

Improving Access to Foreign Markets: Since free and fair trade is so important to our farmers in terms of receiving a profit from the market, we believe several actions are in order:

- Passing trade negotiating authority;
- Exempting agriculture from unilateral economic trade sanctions;
- Eliminating unfair export subsidies and trade tariffs of competitors through World Trade Organization negotiations;
- Pursuing ongoing transparency and eventual elimination of State Trading Enterprises and
- Ensuring that international regulation of genetically modified food products are based on sound science, not politics.

Recently, USTR ambassador Zoellick indicates the U.S. is currently only party to two of the 130 free trade agreements that now exist. Given the state of American agriculture, we cannot afford to be shut out of preferential trade agreements while allowing our trade competitors to reap the benefits.

Diversifying Rural America

Mr. Chairman, one important aspect of strengthening the farm safety net involves helping rural communities diversify their sources of income and their local economies. More and more farm families appear to be relying on off-farm income to support the farming enterprise. USDA statistics indicate that 90 percent of the total income of farm households comes from off-farm sources. Of course, this is an average and a significant portion of the farm population relies just on farm income.

Yet trends indicate that counties which have relied largely upon agriculture as the main industry lost significant population in the last decade. For example, the FDIC's first quarter 2000 Regional Outlook report on the Kansas City region highlighted these troubling trends. Only about one quarter of the 400 rural counties studied were growing. The recent 2000 census revealed that while the general population grew 13 percent in the 1990's, 676 counties, primarily rural counties, lost population. Those counties losing population are largely dependent on agriculture. This shows the importance of diversifying our rural economies which will help keep people in rural America and will help farm families have additional sources of income thereby reducing the need to rely solely on farm programs for survival in rural America. The more diversified economies in rural America appear to be the most viable for the long term.

Maintaining a stable population base in rural areas is important because many demographers say that at some point the populations of communities can fall below a critical mass, destining them for an irreversible decline because they lack the human resources needed to remain viable. The per capita cost of providing services becomes too expensive. Ultimately keeping people, leaders, workers, and citizens in rural communities is essential to keeping a healthy rural social infrastructure which is the foundation of a diverse economic base in our rural communities.

Maintaining the social infrastructure in terms of human resources is key to maintaining a viable physical infrastructure— adequate roads, schools, health care services, utilities, Main Street businesses and, yes, locally owned community banks focused on meeting local financial needs.

From the standpoint of the community banks in these rural areas, the loss of population, with its subsequent result of fewer depositors and fewer deposits, is a critical problem since fewer deposits mean fewer funds available to make loans to local businesses and citizens and therefore less investment in the physical and social infrastructure of rural communities.

We Offer the Following Suggestions to Help Diversify our Rural Communities.

Increase Deposit Insurance & Index it to Inflation – Many rural banks are having difficulty growing their core deposit base and thus meeting the lending needs of their rural communities. There are a number of factors at play, but many consequences resulting from these factors could be substantially reduced by doubling deposit insurance coverage and indexing it to inflation. American agriculture is undergoing dramatic changes resulting in fewer and larger farms as well as larger corporate and agribusiness interests. These larger farms and larger agribusinesses, especially at the local level, deal with considerably larger and larger sums of money on a routine basis. Yet, deposit insurance hasn't been raised since 1980 and its value has been eroded in half.

As we all know, millions of retirement accounts have grown well beyond $100,000. The Congress has just increased the attractiveness of educational savings accounts which can now grow to meet the skyrocketing costs of a college education and again the $100,000 level disadvantages community banks. Doubling FDIC deposit insurance and indexing it to inflation will help ensure it keeps up with the savings needs of rural Americans, including farmers who will be looking to retire. In addition, the depositors of many rural banks are older and when they die, their deposits are typically inherited by their children who now live in larger cities. Thus, these funds leave our rural communities.

The result is that money which could have served as lendable funds for business investments and other loans in the community is leaving the rural communities. This only exacerbates the cycle—less investment and opportunity in rural communities and more population flight. New funding sources must therefore be found by the community bank to make up for this loss of depositors and deposits. Increasing the deposit insurance level and indexing it to inflation would be a quick and efficient way to immediately help infuse more funds into our rural areas and ultimately benefit rural citizens, including farm families that depend on off-farm income for survival.

Mr. Chairman, the Center for the Study of Rural America, headquartered in the Federal Reserve Bank of Kansas City, is a national rural outreach committed to illuminating the issues and challenges facing rural America. In their recent national conferences, the Center has begun exploring the need to outline a broader rural policy that goes beyond only farm policy. Diversifying our rural economies is a key challenge in the 21st Century.

An additional issue the Center has examined is the need to bring more sources of equity capital to rural America to complement the debt financing offered by private-sector lenders. We welcome these explorations.

Oppose Expansion of Farm Credit System Lending Authorities

During a similar testimony before the Senate Agriculture Committee, the Farm Credit System's witness asked for new legislative authorities as Congress considers a new farm bill. FCS made a number of questionable and startling claims. I want to address a few of these issues in my testimony today and we will follow up with the committee to discuss the issue of FCS lending authorities in the days ahead.

FCS made the claim that their authorities remain basically unchanged since Congress enacted the Farm Credit Act of 1971 – some thirty years ago. FCS also claimed that "commercial banks, in effect, are now GSEs with virtually unlimited operating authority". These claims are nonsense. Commercial banks are not considered to be GSEs or their equivalents by the capital markets. FCS also suggested that deposit insurance is equivalent or superior to their GSE status, the latter which provides low-cost funding and numerous tax exemptions. The cost of deposit insurance is borne by the banking industry through premium assessments unlike the privilege of being a GSE.

We remind the committee that FCS can borrow low cost funds from the capital markets due to their GSE status. While it is not explicitly guaranteed by the government, the capital markets believe it is safe to advance funds to the FCS at very favorable rates because the government would not allow a GSE to fail. This is true. FCS would have failed in the 1980's had Congress not passed three bailout bills including providing the FCS with a $4 billion line of credit to the government. At the same time that Congress protected the FCS against failure, hundreds of community banks were allowed to go under. *So keep in mind that deposit insurance protects the savings of insured depositors, it does not protect commercial banks against failure*. In turn, uninsured depositors can be at risk when a community bank fails. But the FCS has been protected against failure.

FCS in their May 16 testimony also seemed to suggest that FCA was an obstacle to reducing regulatory burden. In fact, quite the opposite is true. In fact, FCA has been a "partner" to the FCS in seeking to expand their authorities through regulatory fiat. FCS has expanded the scope of FCS lending and the customers eligible to borrow through "scope and eligibility" regulations adopted in 1997. These regulations included loans to farm related businesses, even those businesses which may only receive a minority of their income from providing farm related services. FCA has expanded housing loan authorities for FCS; loan participation authorities even to the extent of allowing FCS to "buy" whole loans through 100-percent participations. This enacts by regulation what Congress rejected as a legislative proposal. As you know Mr. Chairman, FCA is also now reviewing a major proposal which will also expand FCS lending opportunities through "national charters" which we have testified on and which we oppose for many reasons.

An example of other FCA regulatory initiatives include: a final rule allowing FCS service corporations to sell stock to non-System persons or entities; elimination of over three-dozen regulations considered "burdensome or unnecessary"; repeal of the requirement for FCA prior approval of FCS activities; elimination of requirements for FCS institutions to disseminate quarterly and annual reports to shareholders; allowing FCS institutions to develop their own lending policies and underwriting standards; and elimination of borrower stock purchase and borrower rights requirements for loans sold into the secondary market. These are just a few of the many examples of regulatory relief the FCS has been provided. There has been no lack of proposals made by the FCA on behalf of the FCS.

In fact, in announcing these regulations, which reduced FCA oversight, reduced regulatory burden and often expanded powers of FCS institutions, FCA made several statements like this one: "This is yet another step in the FCA's continuing efforts to reduce the regulatory burden on FCS institutions". In fact, FCA requested in1998 for commenters to "identify any FCA regulations or policies that duplicate other requirements, are ineffective, or impose burdens that are greater than the benefits received". They then extended that comment period for an additional two months.

FCS has also received expanded lending authorities through legislation. An example of some of these legislative expansions include: PL #99-108 (signed 12-23-85) which amended the Farm Credit Act of 1971 to expand the category of eligible rural utility borrowers; the Agricultural Credit Act of 1987, PL #100-233; the Farm Credit Banks and Associations Safety and Soundness Act of 1992, PL #102-552, (signed 10-28-92) which expanded water and sewer lending authority for cooperatives; and the FCS Ag Export & Risk Management Act, PL #103-376 (signed 5-10-1996) allowing FCS relief in numerous areas.

We believe it is time to stop expanding FCS lending activities. FCS appears to be trying to elicit sympathy from the agriculture committees. We would object to FCS being given authority to take away loans being made by the private sector through their tax and funding advantages. This would not expand the economic base of rural America or bring new businesses into our rural areas. FCS did not describe their proposal for "value-added agriculture" nor did they define the scope of this proposal. FCS did not suggest ways they would be willing to work cooperatively with local lenders in the local communities to truly further rural development.

We note that the FCS has made net profits of well over $1 billion for more than a decade. In addition, the degree of their lending to young, beginning and small farmers is suspect, especially in terms of utilizing the USDA guaranteed loan programs. USDA economists have reported on the lack of use of this program by FCS, a program that obviously targets borrowers who need help in the form of a guarantee from a lender in order to obtain credit. The FCS's feet need to be held to the fire in terms of being made more accountable. In addition, the OFI program, whereby "Other Financial Institutions" can obtain funding from the FCS to make loans in their communities, has been made a virtual non-factor by the FCS and has too many constraints placed upon it by statute.

If FCS truly wants competition, they should be proposing ways to make the OFI program more workable and we do have a number of suggestions. Also, FCS institutions should be willing to have the same tax responsibilities as do commercial banks. Many community banks pay taxes at the highest tax rates while FCS taxes are minimal if not non-existent. In fact, many FCS institutions have restructured themselves in order to avoid paying taxes. If commercial banks had the same tax advantages as FCS lenders, banks could also build up their capital more quickly and pass on these savings to their borrowers in the form of even lower interest rates. So if we want to discuss competition, let's also discuss whether the playing field is level. We've seen what happens in our trade markets when the playing field is not level.

Mr. Chairman, FCS has not, to our knowledge, proposed any ways that commercial banks and the FCS institutions can work together to expand the economic base of our rural communities. What they seem to be asking you for is the ability to leverage their government derived privileges to drive out private sector lending activities from our rural areas. This is not constructive. This obviously causes us great concerns and is one reason why we would oppose expanding FCS powers in conjunction with passing a new farm bill.

Summary

Mr. Chairman, we appreciate the Committee's efforts on behalf of American agriculture and rural America. Strengthening the farm safety net by passing a new farm bill that includes counter-cyclical income support mechanisms and greater business investment opportunities in our rural areas are essential ingredients to a viable future for many farm families. Additional longer-term solutions involving successful trade negotiations will also be very important to rural America's future. ICBA and its Agriculture-Rural America Committee looks forward to working with the congressional agriculture committees to accomplish these goals. Thank you.